DIGGING OUT: THE RAUNER WRECKAGE REPORT

AN INITIAL REVIEW TO UNEARTH A MORE COMPLETE PICTURE OF THE COSTS OF FAILURE AND IDEOLOGICAL WARFARE

ABSTRACT

Four years of failure and ideological warfare in Illinois state government created a mess that will take years to put behind us. Many of the worst consequences are well-known: more than $1 billion in interest penalties, the decimation of human service providers, college enrollment that dropped by more than 70,000 students, and universities in jeopardy of losing their accreditation. This report builds on previous work and identifies damage that is even worse than previously known, including a projected $3.2 billion budget deficit for FY20 that is 16 percent higher than previous estimates.

Deputy Governor Dan Hynes

February 7, 2019

Executive Summary of Findings

1. If left unaddressed, the State of Illinois' general funds budget deficit for FY20 would be approximately $3.2 billion, roughly 16 percent higher than the Rauner administration officially estimated just three months ago.

2. The state's debt associated with unpaid bills is nearly $15 billion: $7.9 billion in unpaid bills, $5.5 billion in backlog borrowing, $650 million in interfund borrowing and $500 million in estimated backpay for state workers. This is almost triple the amount outstanding before Governor Rauner's impasse began.

3. Rauner's failed and prolonged dispute with AFSCME over step increase wages has resulted in a court finding that he improperly withheld wages from state employees. The cost of his anti-union battle may total more than $500 million with the impact of compounded interest penalties.

4. The State's projected unpaid bill backlog at the end of FY19 is likely to be $500 million more than previously stated, creating longer delays in vendor payment cycles and additional pressure on the provider community – and, most critically, the vulnerable Illinoisans they serve.

5. Interest alone on additional general obligation bonds attributable to the refinancing of Rauner's bill backlog will exceed $2 billion.

6. Late Payment Interest Penalties that built up during the impasse exceeded $1.25 billion. Continued interest payments will likely exceed $60 million in FY19 in part because this year's budget maintains a structural deficit that went unaddressed during Rauner's term.

7. The State's management and administrative infrastructure has deteriorated significantly, with major fiscal, legal and other critical positions unfilled for years. Reductions in staffing have affected public safety and social service programs.

8. The mismanagement of state contracts has allowed increased costs and lengthy project delays, resulting in, for example, information technology systems that don't function effectively. This mismanagement severely impacts the administration and delivery of vital services, including healthcare. In some cases, it threatens the flow of federal reimbursement funds. The mismanagement extends to basic government functions like processing revenues and paying rent.

9. Tens of millions of dollars have been and will continue to be allocated to comply with court orders and consent decrees due to management failures to address the state's most serious challenges.

Overview

The choice by the Rauner administration to wage ideological warfare took a severe toll on our state: plunging us deeper into debt and causing severe damage to our social safety net and higher education. Human service agencies closed, and college and university enrollment plunged. The Rauner years will have ripple effects for a generation to come on those who suffered direct harm, including taxpayers. Illinois already had fiscal challenges to overcome, but the previous administration drove the state into a ditch.

Rebuilding a strong financial foundation for Illinois will take more than one year, or even one gubernatorial term. The current administration is committed to working diligently and across party lines to put our state on a path to fiscal stability. That starts with an honest accounting of the budgetary and administrative challenges that now exist – and that this administration will work to fix.

Left unaddressed, the State of Illinois is facing a $3.2 billion budget deficit in FY20, exceeding the previous administration's November 2018 estimate of $2.765 billion by nearly $500 million. This enormous deficit – nearly 9 percent of the state's General Funds revenue collections – was compounded by the disastrous future financial ramifications of Governor Rauner's approach. The missed opportunities are staggering; the investments in human capital that we have foregone are tragic.

Overall, the state started calendar year 2019 with more than $7.9 billion in unpaid bills to schools, health care providers, universities, businesses and many more – that's after a $6 billion refinancing (which Rauner vetoed) and it's $2.9 billion more than before Governor Rauner's impasse began. In all, with the $500 million unpaid AFSCME step increases, Governor Rauner left taxpayers with a $14.5 billion bill and nearly tripled the unpaid bills his predecessor left for him.

Because the state went without a budget for longer than any other state in history, Illinois racked up late payment penalties, with an estimated total bill exceeding $1.25 billion related to the impasse alone. For context, this amount exceeds the total interest penalties generated in Illinois over the previous 15 years combined[1]. Last year alone, the State paid out more than $700 million in late payment penalties – about what we spend on the Department of Children and Family Services, or enough to hire at least 7,000 new teachers across the state.

Record payment delays and lack of funding forced vital human service agencies to reduce staff and service levels or shutter their doors permanently. The unpredictability of state funding created insurmountable difficulties for many vendors across the state, some of whom have chosen to no longer do business with the state while others of whom were forced out of business.

At the same time, the state made virtually no progress in managing its pension responsibilities and the governor developed no realistic plan to address them going forward. As a result of these management

[1] https://illinoiscomptroller.gov/financial-data/find-a-report/special-fiscal/special-report-on-late-payment-interest-penalties-april-dta-addendum/

failures and others described in this report, Illinois now suffers the lowest bond ratings in the United States – making every dollar the state borrows more expensive to repay.

Furthermore, as this new administration continues to unearth the true costs taxpayers now face, another clear finding is that the previous administration failed to perform other strikingly basic tasks of government, including:

- Allowing massive project delays and cost overruns for IT systems that still fail to function properly, putting vulnerable citizens at risk for losing healthcare services;
- Permitting staffing levels to atrophy at critical executive branch agencies, including reducing the numbers of State Troopers and understaffing caseworkers at human services field offices;
- Ignoring audit findings, leading to costly consent decrees;
- Failing to process revenue receipts in a timely way;
- Defaulting on rent payments – for instance, on the administration's federal office in Washington DC;
- Failing to follow federal OSHA and Illinois Department of Labor staffing enforcement plans. This lack of adequate staffing put state, local and private sector workers at greater risk of on-the-job injuries. Failure to comply also resulted in the loss of nearly $3.2 million in federal funding – almost 50 percent of federal OSHA funding in FY17 and FY18.

As the new administration takes the reins of each agency, this list seems to expand every week. Overcoming these challenges is made more difficult by the previous administration's inability or unwillingness to fill key administrative positions in various state agencies because, for years, many agencies lacked fiscal officers, legal counsels or both, to say nothing of important program management personnel.

Lower Revenue, Unpaid Bills, and Higher Interest Rates

During FY16 and FY17, Illinois operated without a fully appropriated budget due to a prolonged standoff that was unprecedented in our nation's history. During those two years, Illinois made some expenditures and payments because they were required by court orders, consent decrees and continuing appropriations. Many state commitments for social service programs, higher education, agency operations and state employee health insurance lacked sufficient appropriations, which led to extensive delays in payments for contracted services.[2] The unpaid bill backlog soared, reaching a peak of $16.7 billion. It is important to note that even after the resolution of the budget impasse, the state continues to operate under a variety of consent decrees and judicial orders that dictate resource management and spending priorities for the largest state agencies, including the Department of Healthcare and Family Services, the Department of Human Services and the Department of Corrections.

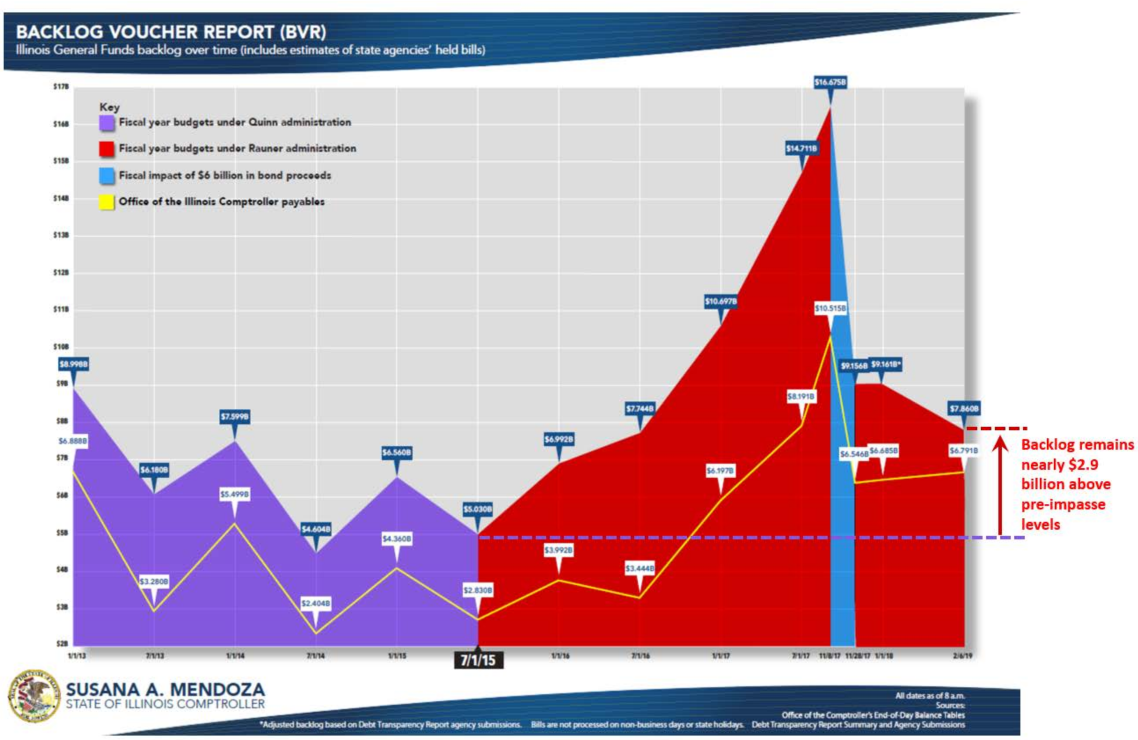
[2] https://illinoiscomptroller.gov/financial-data/find-a-report/special-fiscal/consequences-of-illinois-2015-2017-budget-impasse-and-fiscal-outlook/

These agencies comprise a large portion of the expenditures of state government, and therefore the annual cost of these court orders and consent decrees is likely in excess of $100 million per year.

Because the impasse arose during the time that state income tax rates had partially rolled back from the 2011 increases, annual revenues fell off by more than $4.5 billion between FY14 and FY16.[3] With revenues substantially out of line with expenditure levels, the state was forced to delay payments to vendors to make it through the impasse years.

As a result, by the end of FY17, Illinois' backlog of bills reached an estimated $14.7 billion, a nearly $10 billion increase from the end of FY15. With a substantial portion of the backlog accruing interest costs at rates between 9 percent and 12 percent annually, the FY18 budget included authorization for $6 billion in general obligation bonding authority to pay down a portion of the remaining backlog. While the arbitrage from these bonds will save the state an estimated $4 to $6 billion, the interest alone on these bonds will cost Illinois $2 billion over the life of the debt.[4] This bonding, in combination with the leveraging of federal funds, paid down over half of the bill backlog. However, at the end of December 2018, the backlog of bills remained at $7.9 billion (nearly $2.9 billion more than before the budget impasse).[5]

Chart 1: Bill Backlog, 2013-2019



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[3] Fiscal Year 2019 Budget Summary, Commission on Government Forecasting and Accountability. http://cgfa.ilga.gov/Upload/FY2019BudgetSummary.pdf

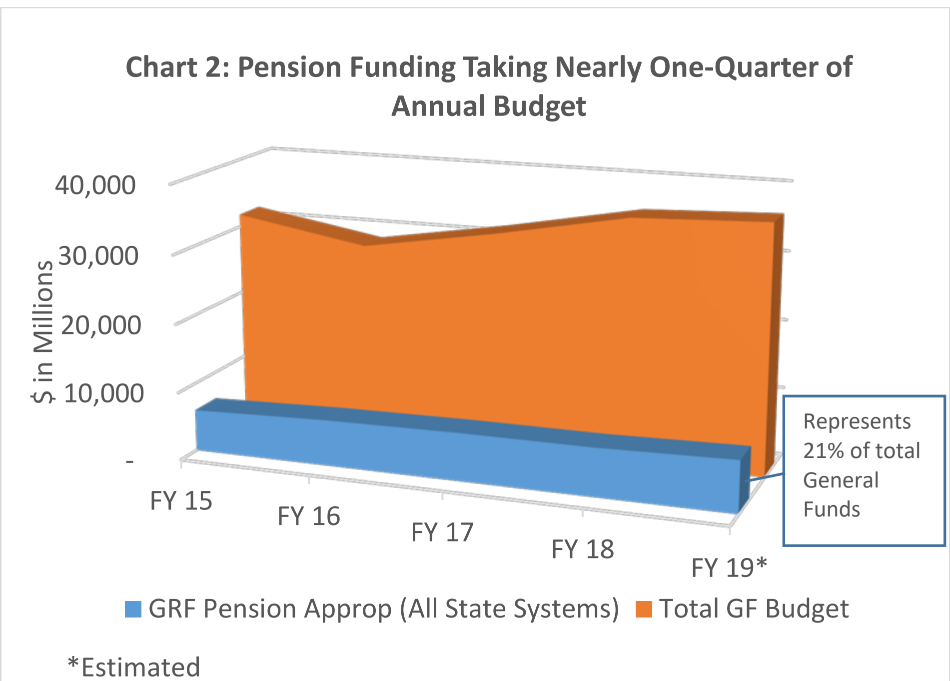
[4] https://illinoiscomptroller.gov/financial-data/fiscal-focus-blog/long-term-taxpayer-savings/

[5] https://illinoiscomptroller.gov/financial-data/fiscal-focus-blog/bill-backlog/

During FY16, FY17, and FY18, approximately $1.25 billion in late payment interest penalties accrued related to the budget impasse.[6] So far in FY19, the state has processed an additional $39 million in interest penalties on the remaining bill backlog. Spending on these unnecessary late payment fees inevitably continues to crowd out other needed investments.

Continued Backsliding on Pensions

While interest continues to accrue on overdue bills, the state's largest obligation – pensions – continues to take up a greater and greater share of the state budget. In FY20, the required state contributions to the state retirement systems is scheduled to hit $9.2 billion, representing nearly one-quarter of the state's annual general funds budget, and $600 million more than in FY19.[7] Overly aggressive assumptions built into the FY19 budget about implementation timeframes of the voluntary buyouts of pensions or COLAs will likely increase the state's pension contributions beyond what was previously expected.



[6] https://illinoiscomptroller.gov/financial-data/find-a-report/special-fiscal/special-report-on-late-payment-interest-penalties-april-dta-addendum/ and Comptroller records on FY18 spending
[7] http://cgfa.ilga.gov/Upload/1118%20SPECIAL%20PENSION%20BRIEFING.pdf The final FY19 amount will not be known until the systems recertify amounts in June 2019 based on results of the pension obligation acceleration buyout program.

Failure to Negotiate with AFSCME

As part of his campaign to undermine labor unions, Gov. Rauner refused to negotiate a contract with AFSCME, which represents the majority of state employees. Instead he proposed eliminating their collective bargaining rights, cut state pension benefits and cut workers' compensation rates. When these proposals were rejected at the bargaining table, rather than working toward compromise, the Rauner administration walked away from the bargaining table. As a result, courts have now ordered that the administration must grant employees increases (or "steps") that were not paid during FY16 through FY19. The Rauner administration itself estimated that the cost of addressing unpaid steps could cost $500 million[8], but neglected to acknowledge that the eventual cost could rise due to compounded interest costs from that administration's failure to comply with court orders. The vicious truth is that Governor Rauner's obstinate approach had the opposite of his intended effect on state government finances: he lost the opportunity to negotiate down the overall cost to taxpayers and incurred potentially significant interest payments.

Illinois Suffers Eight Credit Downgrades

During the impasse, the cost of issuing state debt became substantially more expensive as a result of numerous downgrades from ratings agencies. Illinois' general obligation bond rating was downgraded a combined eight times by Moody's Investors Service, Fitch Ratings, and S&P Global Ratings. During Governor Rauner's first 30 months in office, the state averaged one credit downgrade for every 109 days. As the state was reaching the end of the impasse in June 2017, the rating agencies threatened downgrading Illinois' general obligation bonds to non-investment grade, or "junk," status. That would have been a dubious distinction for a major state. Current general obligation bond ratings remain a dismal Baa2, stable outlook; BBB-, stable outlook; and BBB, negative outlook (Moody's, S&P, and Fitch, respectively). Illinois' general obligation bond ratings are the lowest among the states, costing more than $75 million a year in additional interest costs on bonds issued since 2017. That is the equivalent of an additional 25,000 MAP recipients per year since 2017 – or enough for MAP grants for every undergraduate student at SIU-Carbondale and Illinois State every year.

If not reversed, the near junk credit rating achieved by Rauner's failures means that all future refinancing or new borrowing will cost the state hundreds of millions of dollars each year in additional interest.

[8] https://www.sj-r.com/news/20180731/union-says-gov-rauner-is-dragging-feet-on-step-raises

Budget Impasse Impact on Critical Service Providers and the Neediest Illinoisans

Many essential state services had limited or no appropriations available during the impasse – and those that could receive payments often faced long delays. Examples of the devastating impact of these delayed payments include:

- Lutheran Social Services of Illinois, one of the largest human service agencies in Illinois, was forced to reduce its budget by 20 percent, cutting 750 jobs in areas such as mental health counseling and alcohol and drug treatment rehabilitation.[9]
- Mahoney Transitional Living facility, which sheltered homeless youth in Hardin County, closed.
- The Haymarket Center, which serves more than 1,000 adults in the Chicago area suffering from substance abuse, closed its social setting detoxification program.
- The Wells Center, a drug and alcohol treatment center in Jacksonville serving 500 people annually, closed due to cash flow issues stemming from the state's budget impasse.[10]
- Transitions of Western Illinois was forced to close several of its programs serving homeless youth.

There are also long term impacts on people and programs as a result of the diminished condition of human service agencies and their reduced capacity to serve clients. For example, the state's Child Care Assistance Program, which provides low-income families with access to affordable and quality child care, served approximately 154,000 children before the budget impasse began, but as eligibility requirements were severely restricted by the prior administration, the caseload fell off by over 40,000 children. Even three years after eligibility was increased, the program serves 30,000 to 40,000 fewer children than it did prior to the impasse.

Further, according to the Illinois Public Health Association, the impasse prompted as many as 30 percent of Illinois' 97 county-level health departments — mostly the small and mid-size agencies — to trim operating hours, staff and programs. Even after passage of a fiscal 2018 budget, the IPHA executive director noted that not all health departments were able to restore their hours and staff, saying: "We have a long way to go to recover from the budget impasse."[11]

Negative Impact on the State's Higher Education System

Funding for the state's higher education systems had seen a steady decline since the early 2000s, but it fell off a cliff during the impasse. In FY 16, universities received state general funds support totaling approximately $350 million, down from nearly $1.2 billion in FY15 – a one-year cut of approximately

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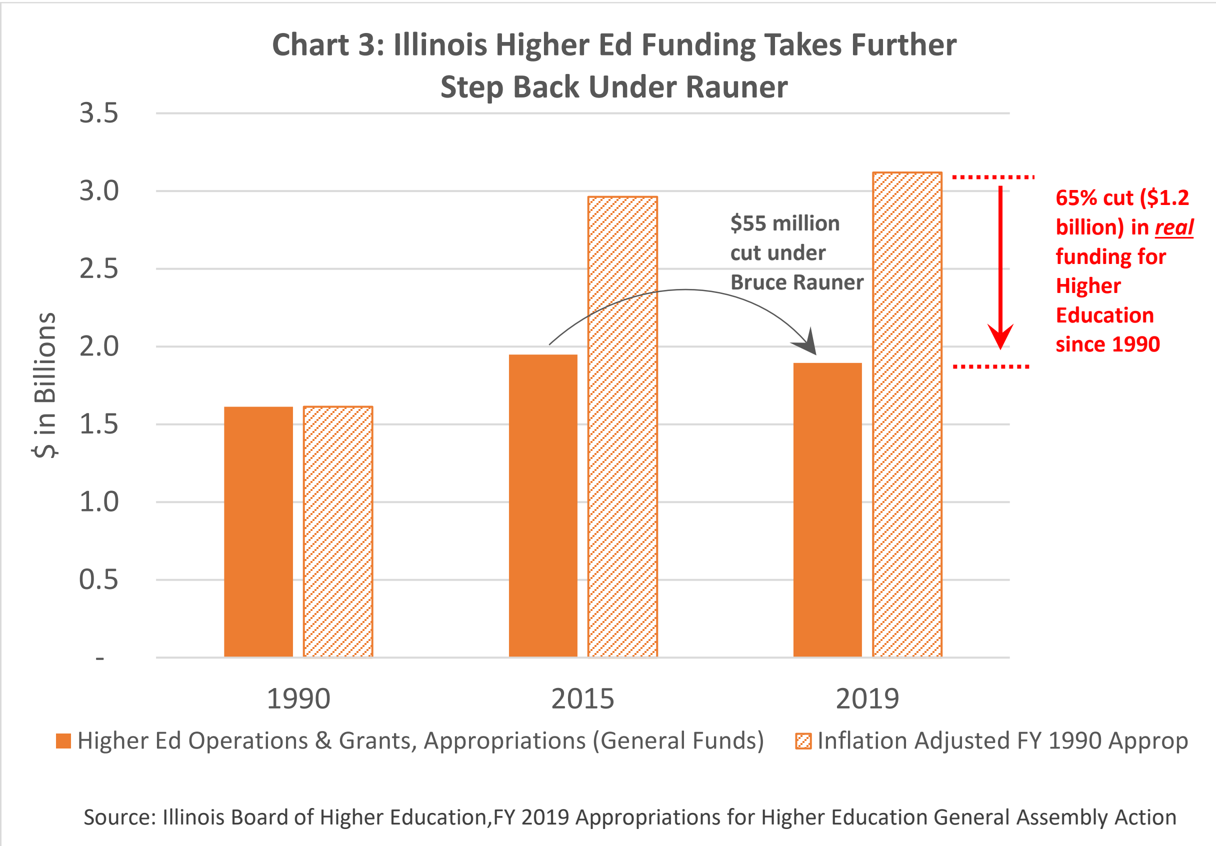
[9] https://www.chicagobusiness.com/article/20160122/NEWS07/160129931/lutheran-social-services-of-illinois-cuts-jobs-programs-amid-budget-impasse
[10] https://illinoiscomptroller.gov/financial-data/find-a-report/special-fiscal/consequences-of-illinois-2015-2017-budget-impasse-and-fiscal-outlook/
[11] https://will.illinois.edu/news/story/health-care-providers-try-to-recover-from-impasse

70%.[12] 72,000 college students fled the state.[13] While funding was increased at closer to pre-impasse levels in FY 17, FY18, and FY19, funding for higher education in FY19 remains 65 percent less ($1.2 billion) in inflation adjusted terms than it was nearly 30 years ago.[14]



The impasse also threatened the universities' access to credit markets and their accreditations. Universities had multiple credit downgrades, with some falling below investment grade, risking the universities' accreditation.[15][16] Five universities fell to junk credit status.

Additionally, the threat of not funding the state's Monetary Award Program (MAP), a college tuition grant program, deeply impacted lower income students who could not commit to going to college due to a lack of certainty of state funding commitments.

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[12] https://www.civicfed.org/iifs/blog/higher-education-funding-shortfall-persists-despite-new-budget
[13] https://illinoisupdate.com/2017/09/06/illinois-public-universities-damaged-by-state-budget-impasse/
[14] https://www.ibhe.org/assets/files/FY19BudgetBook.pdf
[15] "S&P Downgrades Six Illinois Universities' Credit Ratings," Reuters, 4/20/17.
[16] Parker, Molly. "Budget impasse could have 'accreditation consequences' for Illinois colleges and universities," The Southern, 6/27/17.

It is impossible to overstate the generational impact of the budget impasse on the state's universities. Governors for decades to come will be forced to confront the ripple effects of decisions the Rauner administration made regarding higher education. Students who would have attended college couldn't, while others left the state to attend more stable universities they could afford. Faculty that took years to recruit to Illinois were poached by out-of-state universities that offered greater certainty and stable student enrollments. As a result, Rauner's budget decisions may have cost Illinois billions in economic growth potential of thousands of top tier students – future entrepreneurs, employers, higher wage workers and taxpayers.

Other Detrimental Impacts to Illinoisans Over the Last Four Years

In addition to the financial damage done to the state over the last four years and its resulting impact on Illinois' most vulnerable residents, one of the most tragic events came in the form of the Rauner administration's handling of the Legionnaires' disease outbreak at the Quincy Veterans' Home. By September 2015, 54 people from the home tested positive for Legionnaire's disease, 12 of whom died due to the illness. Following this event, Legionnaire's has been found in surrounding areas; further highlighting the critical need for meaningful infrastructure investment by the state. Rebuilding the Quincy Veterans' Home is estimated to cost the state in excess of $100 million along with a larger match from the federal government.

Other state-run facilities continue to struggle to provide adequate care. Insufficient medical care for inmates at the state's correctional facilities led to the Lippert consent decree in December 2018, as the state is still grappling with the costs associated with meeting the requirements under the Rasho settlement for mental health treatment from 2016. In FY20 alone, this will lead to cost increases for medical and other care at Correctional facilities in the tens of millions of dollars range and implementation of an electronic medical records system that will cost millions of dollars.

Other continuing financial pressures that will require State investment going forward include:

- Increasing funding for the Illinois State Police to help rebuild their ranks after the suspension of cadet classes in FY16 and FY17 led to a decline in state troopers. It will cost Illinoisans over $8 million in FY20 for two cadet classes to help build their ranks.
- Requirements for Illinois Department of Children and Family Services (DCFS) to put into place a federally compliant child welfare information system.
- Reversing the damage done when a new Integrated Eligibility System (IES) failed to achieve its desired outcome. The IES was intended to make the Long-Term Care application process more efficient but actually did the opposite, resulting in increased delays in processing applications and admissions under the previous administration.

Deeper Deficit: A 16 Percent Increase

If left unaddressed, the State of Illinois' general funds budget deficit for FY20 will be approximately $3.2 billion, roughly $440 million higher than the Rauner administration estimated in November. As agencies have submitted maintenance budget requests, widespread cost pressures have become evident – and it has become clear that in order to deliver basic services throughout the state, those pressures must be addressed. For instance, the Rauner administration's November estimate reflected a 1 percent increase in higher education funding, but years of limited higher education funding mean that the true needs are larger than the Rauner administration's November estimate.

In other areas, human service agencies continue to see cost pressures for caseload growth, rate increases, and expected costs related to the long-delayed opening of the Chicago Veterans Home. Public safety agencies project growth in costs related to medical care consent decrees and settlement agreements, while the State Police continue to need to add troopers to make up for no cadet classes during the impasse. State employee health insurance costs continue to grow as liability growth exceeds 3 percent, and the program faces high interest costs due to late payments. General Funds Medicaid appropriation needs are less than originally estimated as the Department of Healthcare and Family Services has identified other available resources to support the moderate growth in the base Medicaid program liability.

With all those pressures, it's clear that a more realistic beginning budget deficit must be calculated. In addition, the people of Illinois have a number of priorities, including investing in early childhood education, schools and raising workers' minimum wage.

A revised deficit projection is found in the chart below.

FY20 Revised General Funds Maintenance Deficit Projection
November 2018 Economic and Fiscal Policy Report vs. Revised Estimates
($ in millions)

Report Deficit Projection	**(2,765)**
Higher Education	(70)
Human Services	(275)
Public Safety	(30)
State Employee Health Insurance	(170)
Government Services	(65)
Net Healthcare Adjustment	170
Revised Deficit Projection	**(3,205)**

Conclusion

The human and financial costs that have accrued over the last four years – to say nothing of the missed opportunity to stabilize Illinois' finances during a period of relatively strong economic growth – will require a tremendous amount of effort to remedy going forward. The state is facing a $3.2 billion structural deficit in its general funds, still owes millions of dollars in accrued interest penalties, and was left with a $14.5 billion bill from the previous administration. There are potentially as much as a half billion dollars in unaddressed labor costs accrued during the last administration and continues to face steep increases in the annual requirements to fund its pension systems. At the same time, the state must find a way to make critical – and long deferred – investment in the infrastructure and services that contribute to a thriving economy.

Four years of failing to face these challenges only compounded the financial implications to the state and taxpayers today. For anyone who reviews the State's finances, these years were such an anomaly that they will forever have an asterisk beside them. While a generation of future Illinoisans will be forced to deal with the ramifications of Gov. Rauner's fiscal wreckage, the new administration will use its first budget to light a multi-year path forward to fiscal stability and a new prosperity for Illinois.

A special thank you to the Office of the Illinois Comptroller for groundbreaking and significant research on the true costs of the budget impasse and the state's backlog of bills; this report is built on and extends that research with additional findings.